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Dan Walters: Fiscal woes becoming ever deeper

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Elizabeth Hill, the Legislature's long-serving budget analyst, is the epitome of a low-key civil servant. Her dry, if authoritative, reports on state finances reflect that diffident demeanor.

When, therefore, Hill italicized some of the key words in her latest appraisal of the state's worsening fiscal dilemma Wednesday, it was her equivalent of shouting. And to translate those shouting words into everyday language, the state is in deep doo-doo, Gov. Arnold Schwarzenegger and the Legislature are running out of gimmicks, and they'd better get serious before it becomes a full-blown debacle.

Specifically, Hill says this year's budget – the one that Schwarzenegger crowed was balanced with a \$4.1 billion reserve – is already upside down, thanks to some fiscal trickery that misfired and a slowing economy, including the bursting of the housing bubble, that has dampened revenues.

The \$4.1 billion reserve has already morphed into a \$1.9 billion deficit for the year, Hill projects, and the state can look forward to another \$8 billion gap between income and outgo in 2008-09 unless the governor and lawmakers slash spending and/or raise taxes.

The Legislature "will need to develop a budget plan that provides almost \$10 billion in solutions," Hill wrote. "Addressing the state's current budget problems is even more urgent because we forecast a continuing gap between revenues and expenditures. Without permanent budget solutions, the state will continue to face annual budget problems. A plan to permanently address the state's fiscal troubles must involve ongoing solutions." Some of Hill's italicized shouts are in that passage.

So there it is, official confirmation of the \$10 billion problem that some journalists and outside analysts had already calculated, and, as if to underscore the dilemma, Schwarzenegger's own Department of Finance released a report saying that revenues through the first four months of the fiscal year are running more than \$1 billion under expectations.

Will 2008, one wonders, be the year when the Legislature and the governor – who was elected to clean up the state's chronic fiscal mess and has utterly failed – eschew the funny-money gimmicks and backdoor borrowing that have permeated budgets over the last six years and get serious?

It could mean touching a third rail of Capitol politics, the 1988-vintage ballot measure, Proposition 98, that guarantees schools an ever-rising level of financing regardless of the state's fiscal situation – no small irony, given Schwarzenegger's pledge to make 2008 the year of education reform. Or it might mean cuts in welfare and health care for the poor, another irony given that the governor and legislators are trying to expand health access, not reduce it.

It could mean even higher college fees or sharply reducing prison populations with all the political angst that would generate. K-12 schools, health care, welfare, prisons, higher education and servicing the state's rapidly mounting bond debt consume all but a tiny portion of the state's general fund budget.

On the other side, permanently closing an \$8 billion operating deficit – just about the size it was in 2001, incidentally – would take a 2-cent increase in the state sales tax, or about a 15 percent increase in state income taxes. Or it might require a brush with another third rail, the property tax limit, Proposition 13, that voters enacted in 1978.

Historically, Democrats have believed that holding the line on spending would eventually force Republicans to raise taxes. Republicans have believed that if they hold out on taxes, Democrats will eventually make big spending cuts. The stalemate has generated years of deficits and massive borrowing to cover them.

What will happen? Absolutely no one knows.